BRIEF IN SUPPORT OF PETITION.

Opinions Below.

The Opinion of the District Court is not officially reported. It appears in the Record, at page 8.

The Opinion of the Circuit Court of Appeals is reported in 117 Fed. (2d) 477. It appears at page 22 of the Record.

Jurisdiction.

See Petition for Writ of Certiorari, "Jurisdiction", page 4, *supra.*

Statement of the Case.

See Petition for Writ of Certiorari, "Matter Involved", pages 1 to 4, *supra.*

Specification of Errors to Be Urged.

1. The Circuit of Appeals erred in holding that where the donor of a trust has no power to change the beneficiaries or to recapture the trust property, but only a power to terminate the trusteeship, whereupon the property is to be distributed to the beneficiary, who has a life estate with general testamentary power to appoint the remainder, the value of such remainder interest should be included in the donor's gross estate under Section 302 (d) of the Revenue Act of 1926, as amended by the Act of 1934.

2. The Circuit Court of Appeals erred in holding that the value of a transfer *inter vivos* should be included in the transferor's gross estate under the provi-

sions of Section 302 (d) of the Revenue Act of 1926, as amended by the Revenue Act of May 10, 1934, the said Amendment having been enacted subsequent to the transfer and not having been made applicable by its terms to prior transfers.

SUMMARY OF ARGUMENT.

I.

The power retained by the decedent was merely to put an end to the trusteeship, whereupon the trust property would go to the beneficiary, who already was entitled to the income for life and had a general testamentary power of appointment over the remainder.

Such a power does not render the transfer incomplete and subject to the Estate Tax; because it is not a power to revoke and recapture the trust property or to modify the terms of the trust, so as to designate new beneficiaries or to change the proportionate interests of the named beneficiaries. The retention of such a power is necessary to render the transfer incomplete and subject to the Estate Tax, as established by the rule laid down in the *Sanford case* and put into administrative practice by the regulations of the Treasury Department.

The power retained by the decedent was, at most, a power to change the manner and time of enjoyment of the trust property. As set forth in the amended Gift Tax Regulations, such a power does not render the gift incomplete. It remains subject to the Gift Tax; but is not subject to the Estate Tax.

The decedent's death passed no assurance of title or property to any one; because the beneficiaries, not the decedent, had complete control of the estates in remainder.

II.

The decision of the Circuit Court of Appeals is in conflict with administrative interpretation and practice in assessing the Gift Tax and Estate Tax. Under the form of Gift Tax return promulgated by the Treasury Department, the donor of a trust, subject to a power such as was reserved by the decedent, must return the trust property and pay the Gift Tax based on the value thereof. Being subject to the Gift Tax, the transfer would not be subject to the Estate Tax, under the rule in the *Sanford case.*

Under the decision of the Circuit Court of Appeals in the case at bar, on the other hand, the transfer would be subject to the Estate Tax and, therefore, not subject to the Gift Tax.

III.

At the time of his death, decedent had no power of any kind over the trusts. The exercise of the retained power was subject to a precedent giving of notice to the Trustee, which he never gave. A power subject to such a condition precedent was not reached by the Estate Tax law until the Amendment of 1934, passed seventeen years after the trusts were created. Since the Amendment was not made retrospective by its terms, it is not applicable to transfers prior to its enactment under the decision of this Court in *Hassett v. Welch,* 303 U. S. 303. The decision in the case at bar is in conflict with the decision in the *Welch case.*

ARGUMENT.

Section 302 (d) of the Revenue Act of 1926, as amended by the Revenue Act of 1934.

The Commissioner of Internal Revenue included in the gross estate of the decedent the value of remainders after the death of the life beneficiaries in the two *inter vivos* trusts created by decedent in 1917, to which minor additional transfers were made by decedent in 1932 and 1933. The assessment was justified by the Commissioner and upheld by the District Court and Circuit Court of Appeals, under Section 302 (d) of the Revenue Act of 1926 (44 Stat. 71), as amended by Section 401 of the Revenue Act of May 10, 1934 (48 Stat. 752).

The relevant parts of Section 302 (d) of the Revenue Act of 1926, as thus amended, are set forth in the Appendix hereto, page 26.

I.

The Power Retained by the Decedent Did Not Render the Transfers Incomplete and Subject to the Estate Tax.

The trusts in suit were created in 1917 (R. 15, 17). There is nothing whatsoever to suggest that they were made in an effort to avoid the Estate Tax. Contrary to Judge Clark's statement that the beneficiaries were minors when the trusts were created (R. 22), they were then thirty-seven and thirty, respectively (R. 6). It can not be asserted that the trusts were made by a father in discharge of a legal liability to support minor children. The deeds of trust were executed seven years prior to the time when the section corresponding to Section 302 (d) of the 1926 Act (the asserted basis of the tax) first appeared in a Revenue Act.

In each trust decedent transferred to the Trustee securities in trust, to pay the income to the beneficiary for life and, on the beneficiary's death, to distribute the trust property to such persons or corporations as the beneficiary should appoint by will. The only power retained by the decedent was, as follows (R. 19).

> "The party of the first part [the decedent] hereby reserves the right after six months written notice of his intention so to do, served on the party of the second part [the Trustee], to revoke this trust, whereupon the principal of the trust fund shall be distributed to S. LUCILLE MELLON GRANGE [life beneficiary with general testamentary power of appointment over remainder] and the trust shall end."

[Thomas Mellon is the beneficiary in the other trust (R. 17)].

In spite of his inept use of the word "revoke", decedent reserved neither a power to revoke and recapture the trust property nor a power to modify its terms so as to designate new beneficiaries.

Decedent's only power was to remove the trust with which the transferred property was clothed and cause the property to be distributed to the one person who already had a life estate and sole control over the disposition of the remainder. It is no refinement of terms to state that this was merely a power to terminate the trusteeship and thereby to affect the time and manner of the beneficiary's enjoyment of the trust property.

The question with reference to a transfer such as this is not whether it is taxable; but whether it is the kind of transfer that is subject to the Gift Tax or to the Estate Tax.

In the case of *Sanford v. Commissioner*, 308 U. S. 39, and the companion case of *Rasquin v. Humphreys*, 308 U. S. 54, this Court, in carefully considered opinions by Mr. Justice Stone, set forth the criteria by which a trust should be subjected to the Gift Tax, on the one hand, or to the Estate Tax, on the other.

The Attorney General asserted and this Court affirmed that the Estate Tax and the Gift Tax were *in pari materia* and mutually exclusive, except in the case of gifts in contemplation of death, with which we are not here concerned.

The cases above cited concerned certain powers retained by donors in the creation of trusts. The Commissioner could not determine whether the Government revenues would be increased by a decision that the kind of powers retained rendered the gifts in trust incomplete and, therefore, subject to the Estate Tax or that the gifts were complete and, therefore, subject to the Gift Tax. The latter tax is collectible at once and absolutely; while the former is collectible sometime in the future and peradventure.

The Government stated that it had taken inconsistent positions in the two cases above cited and requested that the resulting confusion be settled by this Court in the interest of consistent administration of the revenue laws.

The question involved was whether a specified power retained by the donor rendered the transfer incomplete and, therefore, subject to the Estate Tax, or did not affect the completeness of the transfer and, therefore, rendered it subject to the Gift Tax.

The rationale of the two decisions is that an incomplete transfer is not subject to the Gift Tax, but is

subject to the Estate Tax. A complete transfer is subject to the Gift Tax, but not to the Estate Tax.

In enunciating the rule for determining what transfers are subject to the Gift Tax, on the one hand, or to the Estate Tax, on the other, Mr. Justice Stone said (p. 43):

> "The rule was thus established, and has ever since been consistently followed by the Court, that a transfer of property upon trust, with power reserved to the donor either *to revoke it and recapture the trust property or to modify its terms so as to designate new beneficiaries* other than himself is incomplete, and becomes complete so as to subject the transfer to death taxes only on relinquishment of the power at death." (Italics supplied)

It is therefore established that if a power is reserved to revoke a trust and recapture the trust property, or to modify the trust so as to designate new beneficiaries, the transfer is incomplete, is subject to the Estate Tax, and is not subject to the Gift Tax. It becomes subject to the Gift Tax, if the power is relinquished by the donor during his lifetime.

It follows that if no such power to recapture or to modify is reserved when the transfer is made—and no such power was reserved in the case at bar—the transfer is subject to the Gift Tax, when made, and is not subject to the Estate Tax on the death of the donor.

As we read the opinion of Judge Clark (R. 22), the decision of the Circuit Court of Appeals is based on the proposition that decedent had retained a power to bring the trust to an untimely end and that this power rendered the transfer taxable, regardless of the subsequent fate of the corpus; that is to say, regardless of the fact

that putting an end to the trusteeship did not result in the recapture of the trust property by the donor or the transfer thereof to new beneficiaries. The opinion concludes, as follows (R. 28):

> "It is clear that revocation is but a method of bringing a trust to an untimely end and has no relation to the consequent and subsequent fate of its corpus. The 'calling back' is of time rather than of space. It seems unnecessary to be troubled by the Treasury's doubts as to the kind of termination or to resort to their ascription of the word itself to 'alter' rather than to 'revoke'."

Under the rule in the *Sanford case,* the fate of the corpus is the touchstone by which it is to be determined whether a retained power renders a transfer in trust incomplete and subject to the Estate Tax or complete and subject to the Gift Tax. It is the power to recapture the corpus, or to transfer it to different beneficiaries, that makes the transfer incomplete. Under the Amended Gift Tax Regulations, as we are about to demonstrate, a mere change in the time or manner of enjoyment of the corpus does not affect the completeness of the transfer and the Gift Tax is incident—not the Estate Tax. The Circuit Court of Appeals sets up time, not space, as the criterion.

We submit that the rule of the Circuit Court of Appeals in the case at bar conflicts with the rule in the *Sanford case.*

The 1940 Amendment to the Gift Tax Regulations.

After this Court's decision in the *Sanford case,* with which existing Gift Tax Regulations were at variance, the Commissioner of Internal Revenue, with the approval of the Secretary of the Treasury, promulgated an amend-

ment to those Regulations putting into administrative practice the rule laid down in the *Sanford case.*

No reference to the Amendment or to plaintiffs' position based thereon is contained in Judge Clark's Opinion (R. 22).

This Amendment contains the following precept:

"A gift shall not be considered incomplete, however, merely because the donor reserves the power to change the manner or time of enjoyment thereof." [Appendix p. 28].

The retention of such power, therefore, would not render the property transferred subject to the Estate Tax.

The Amendment in question is to Article 3 of Regulations 79, relating to the Gift Tax. That Article, as so amended, is set forth in the Appendix hereto, page 27.

In the case at bar the power reserved by the decedent was, only and at most, power to change the time and manner in which the transferred property could be enjoyed by the beneficiary of the income for life, who had a general testamentary power of appointment over the remainder.

He had an estate tantamount to a fee.

The Supreme Court of Pennsylvania has held that where a testator gives a general testamentary power of appointment to a life tenant—

"* * * the testator has completely relinquished all dead hand dominion over the property and has placed it for all practical purposes as completely within the control of the donee of the power as though a fee had been created in him."

(*Lyon et al. v. Alexander,* 304 Pa. 288, 292; 156 Atl. 84).

In *Wilbur's Estate*, 334 Pa. 45; (5 Atl. (2d) 325), the Supreme Court of Pennsylvania said further, at page 53:

> "A life tenant with a general power of appointment has an estate tantamount to a fee; no one but the donee has any interest in such a power * * *."

"Taxation", Mr. Justice Holmes said, "is not so much concerned with the refinements of title as it is with actual command over the property taxed." (*Corliss v. Bowers*, 281 U. S. 376, 378).

It was not the purpose of Congress, under Section 302 (d), to subject to the Estate Tax transfers where the transferee was for practical purposes the owner of the property. Rather it was the purpose of Congress to tax transfers where the transferor remained for practical purposes the owner. This clearly appears in the Report of the Ways and Means Committee of the House on the proposed Amendment to Section 302 (d) of the Revenue Act of 1926 by the Revenue Act of 1934 (1940 C. C. H. Vol. 3, page 6142). It was there said:

> "This section [Sec. 401, 1934 Act] amends section 302 (d) of the Revenue Act of 1926 relating to the inclusion in the gross estate of a decedent of property transferred by him but as to which he retains the right to alter, amend, or revoke. *In such cases the decedent is for practical purposes the owner of the property which under existing law is required to be included in his gross estate.*" (Italics supplied)

Since in the case at bar the beneficiary, and not decedent, was "for practical purposes the owner of the property", Section 302 (d) is inapplicable.

In the case of *Porter v. Commissioner,* 288 U. S. 436, the basis for the application of Section 302 (d) was that the donor's death passed a valuable assurance of title. The decedent's death, in the case at bar, passed no assurance of title or property to any one. The estates in remainder, included in decedent's gross estate by the Commissioner, were subject to general testamentary powers of appointment by the respective beneficiaries. No one in the world had any assurance that this power of appointment would be exercised for his benefit or would be exercised at all. The reason is that the beneficiary and not the decedent had complete control of the estate in remainder.

We submit that there is no logical or realistic basis for the assessment of the Estate Tax on the transfers in suit or any part thereof and that such an assessment violates the rule laid down in the *Sanford case* and put into administrative practice by the Amended Gift Tax Regulations.

II.

The decision of the Circuit Court of Appeals is in conflict with administrative interpretation and practice in assessing the Gift Tax and Estate Tax.

The *Sanford case* enunciated the rule by which to determine whether a transfer upon trust, with a reserved power, is incomplete and subject to the Estate Tax or complete and subject to the Gift Tax.

Not only has this rule been put into administrative practice by amendment to the Gift Tax Regulations (Appendix p. 27), above referred to, but also by the Gift Tax Returns.

The form of Gift Tax Return (Form 709) prepared by the Treasury Department, on which donors are re-

quired to report transfers in trust, or otherwise, without consideration, was revised in October 1940. The changes in the interrogatories are substantial. They were manifestly made to carry out the Amended Regulations promulgated to put into administrative practice the rule in the *Sanford case.*

Under the Gift Tax Return (as revised), the donor of a transfer in trust, similar to those in the case at bar, would be required to report such transfer as subject to the Gift Tax.

Eliminating irrelevant phrases where indicated, the first interrogatory in the Return is as follows (C. C. H. 1941 Inheritance, Estate, and Gift Tax Service, p. 4903):

> "Have you * * * without * * * consideration * * * made any transfer * * * as follows? (Answer 'Yes' or 'No')
> 1. By the *creation* of a trust (or the *making of additions* to a trust previously created) for the benefit of a person or persons, other than yourself, and with respect to which you retain no power to revest the beneficial title to the property in yourself or to change the beneficiaries or their proportionate benefits, or by *relinquishing* every such power that was retained in a previously created trust .....:
>
> * * * * * * *
>
> "If the answer is 'Yes' to any of the foregoing, such a transfer should be fully disclosed under Schedule A."

In the Return, the Gift Tax is assessed on the value of the transfer shown in Schedule A, less statutory exclusions and exemption.

It is immediately apparent that the donor of a trust, reserving a power like that with which we are concerned, would have to answer the first interrogatory "Yes", and to compute his Gift Tax on the value of the transfer made by the trust.

This is true, because the donor in the instant trusts retained no power to revest the beneficial title to the property in himself or to change the beneficiaries or their proportionate benefits.

But, if such a transfer is subject to the Gift Tax, it is not subject to the Estate Tax, under the rule in the *Sanford case.*

Under the administrative practice of the Treasury Department, a transfer in trust, with a retained power such as that retained by plaintiffs' testator, is, therefore, subject to the Gift Tax. It is, consequently, not subject to the Estate Tax.

But this is contrary to the decision of the Circuit Court of Appeals in the case at bar.

Either the rule in the *Sanford case* must, therefore, be scrapped and the Regulations and forms of Gift Tax Return, promulgated by the Treasury Department, changed; or the decision in the case at bar must be reversed.

A serious, though curious, situation might arise if the forms of Gift Tax return were not changed and the decision of the Circuit Court of Appeals were allowed to stand. This would be that situation—

The donor of a trust retains a power similar to that retained by plaintiffs' testator. Under the Circuit Court

of Appeals decision, the donor would not be subject to the Gift Tax, because he is subject to the Estate Tax.

The donor later relinquishes the retained power. He would not be required to report the relinquishment of such a power for taxation under the Gift Tax Return.

This becomes apparent by reference to the first interrogatory in the Gift Tax Return, above quoted. The donor would properly answer "No" to it; because he had not relinquished a power "to revest the beneficial title to the property in yourself [himself] or to change the beneficiaries or their proportionate benefits."

The transfer would not be subject to the Estate Tax on the donor's death, because he had theretofore relinquished all power originally retained.

We submit that the decision of the Circuit Court of Appeals is not only in conflict with the rule in the *Sanford case,* but would disrupt the administrative practice putting that rule into effect.

III.

The 1934 Amendment to the Revenue Act of 1926 Should Not Be Applied Retrospectively to Transfers Made prior to its Enactment.

We have heretofore argued that the power retained by decedent was not of the kind referred to in Section 302 (d) (1), because it was not a power to revoke and recapture the trust property or to designate new beneficiaries.

Quite aside from this proposition, Section 302 (d) is not applicable to the trusts in suit for the reason that the transfers were not subject even to a power to ter-

minate the trusteeship *at the time of the death of the decedent,* it being recalled that Section 302 (d)(1) requires that the transfer be "subject *at the date of his death* to any change through the exercise of a power, * * * to alter, amend, or revoke, * * *." [Italics supplied] (Appendix p. 26).

The transfers made by decedent were not subject to any power at the date of his death; because he had never given the six months' written notice to the Trustee, which was a condition precedent to decedent's exercising his power (R. 6).

The 1934 Amendment to Section 302 (d), which added Sub-section (2), did purport to reach a transfer where a power to alter, amend, or revoke was subject to such a condition precedent (Appendix p. 26). But the 1934 Amendment was passed seventeen years after the original transfers were made by decedent and, incidentally, only five months and ten days prior to his death on October 20, 1934. The Amendment was not made retrospective by its terms, and therefore, as a matter of statutory construction, should not be applied to transfers made prior to its enactment.

The principle underlying this contention was applied by this Court in the case of *Hassett v. Welch,* 303 U. S. 303.

In that case it was held that, as a matter of statutory construction, the 1931 Amendment to Section 302 (c) of the 1926 Act did not apply to *inter vivos* transfers made prior to its enactment. It was contended by the Collector that the Amendment should be applied to past transactions, because of the provision of Section 302 (h) of the Revenue Act of 1926 making subdivisions (b), (c), (d), (e), (f) and (g) of Section 302 retroactive.

This Court, in an opinion by Mr. Justice Roberts, held that the retroactive provisions of Section 302 (h) of the Act of 1926 applied to the transfers described in Section 302 (c) of the 1926 Act, but not to transfers described in the 1931 Amendment. Since Section 302 (h) of the 1926 Act was not re-enacted in the 1931 Amendment, and since the Amendment was not otherwise made retrospective by its terms, it was held that the Amendment applied only to *inter vivos* transfers made after its enactment.

This is the identical situation presented in the case at bar. The 1934 Amendment, which added Sub-paragraph (2) to Section 302 (d) of the Act of 1926, did not re-enact Section 302 (h) of the 1926 Act and did not contain any provision making the 1934 Amendment retrospective: 48 Stat. 752.

It is, therefore, apparent that the 1934 Amendment applies only to transfers made after its enactment and does not apply to the transfers made by decedent in the case at bar.

In his opinion for the Circuit Court of Appeals, Judge Clark did not cite the *Welch case* or allude to plaintiffs' written and oral argument in that Court based thereon. But, as has been seen, the decision of the Circuit Court of Appeals is directly in conflict with the principle applied in the *Welch case.*

The effect of the retrospective application of the 1934 Amendment would be to impose an Estate Tax on property which the donor thereof had parted with years before, could not recapture, and could not redistribute. That tax would be based on the value of property at the time of the donor's death, which might conceivably have increased to such an extent that the tax would render his estate insolvent. Placed in this situation,

the donor could do nothing to relieve his estate from liability for the Estate Tax, unless he subjected himself to the Gift Tax by releasing the power—a tax which would be based on the value of the property at the time of the relinquishment of the power. Such a hardship would be avoided by the logical application of the principle of statutory construction applied by this Court in the *Welch case.*

Conclusion.

It is, therefore, respectfully submitted that the transfers in trust made by decedent may not be included in his gross estate under Section 302 (d) of the Revenue Act of 1926, as amended by the Revenue Act of 1934.

This petition for a writ of certiorari should be granted and the judgment of the Circuit Court of Appeals should be reversed; because that decision conflicts in principle with the decisions of this Court in the *Sanford case* and the *Welch case* and because it conflicts with the nation-wide administrative practice of the Treasury Department in determining whether transfers in trust with reserved powers are subject to the Gift Tax or the Estate Tax.

Respectfully submitted,

WM. S. MOORHEAD,
WM. F. KNOX,
Attorneys for Petitioners.